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No. 92-270

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1992

PACIFIC FIRST BANK,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF THE SAVINGS AND COMMUNITY BANKERS OF AMERICA AS AMICUS CURIAE IN SUPPORT OF THE PETITIONER

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QUESTIONS PRESENTED

(1) Does a reviewing court fulfill its obligation to "reject administrative contructions which are contrary to clear congressional intent," *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843, n.9 (1984), when it upholds an income tax regulation that substantially increases the effective rate of tax above the level the Conference Committee set as a compromise between the House of Representatives and the Senate?

(2) May the Commissioner of Internal Revenue reverse administrative and regulatory constructions of the Internal Revenue Code in place for more than twenty years and thereby increase the effective rate of tax above the level set by Congress?

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INTEREST OF AMICUS CURIAE

The Savings and Community Bankers of America (SCBA) respectfully submits this brief as amicus curiae in support of the petition for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit. The signed consents of the parties are filed with this brief.

SCBA is the principal national trade association of the savings and loan associations, state-chartered savings banks (referred to in the Internal Revenue Code as "mutual savings banks") and cooperative banks in the United States (collectively referred to hereafter as "thrift institutions") and has approximately 2,100 members.

Its predecessors, the United States League of Savings Institutions and the National Association of Mutual Savings Banks, prepared and filed comments with the Commissioner of the Internal Revenue protesting the regulation at issue in this case, as proposed in 1971, 1974 and 1978. As those comments noted, the effect of the regulation, which was published in final form in 1978 and 1979, was to increase the tax burden of thrift institutions beyond the level intended by Congress when it changed their effective rates of tax in 1969.

Many of SCBA's members have experienced net operating losses in recent years, and most of those members were using the "percentage-of-taxable-income method" under section 593(b)(2) of the Internal Revenue Code of 1954 in their carryback years. These members are faced with an uncertainty as to the proper computation of their bad debt reserves and resulting tax liabilities arising from the unusual status of the issue presented by this case. The United States Tax Court, in an opinion reviewed by all active judges[1], has specifically declined to follow a decision of the Sixth Circuit[2] that, like the decision of the Ninth Circuit[3], upholds the validity of the Treasury regulation at issue. Taxpayers within and without the Sixth and Ninth Circuits are subject to different treatment with respect to the proper computation of their reserves[4]. Prompt resolution of the issue in the context of this case would aid the administration of, and maintain taxpayer confidence in, the tax laws.

More importantly from the view of SCBA, given the materiality of the amounts involved in this issue and the difficult financial condition of some of the thrifts affected by the issue, its prompt resolution would further efforts to place the thrift industry on a solid footing. The regulation at issue in this case directly increased the tax burden of thrift institutions that have experienced net operating losses and that, as a result, are most in need of the special tax relief Congress intended to grant them through the extended carryback period for NOLs created by the Tax Reform Act of 1969.

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[1] *Georgia Federal Bank, F.S.B. v. Commissioner*, 98 T.C. 105 (1992).

[2] *People's Federal Savings and Loan Association of Sidney v. Commissioner*, 948 F.2d 289 (6th Cir. 1991).

[3] *Pacific First Federal Savings Bank v. Commissioner*, 961 F.2d 800 (9th Cir. 1992).

[4] Under the so-called "*Golson* rule," [*Golson v. Commissioner*, 54 T.C. 742 (1970), affirmed 445 F.2d 985 (10th Cir. 1971), *cert. denied* 404 U.S. 940 (1971)] the Tax Court will apply the decisions of the Sixth and Ninth Circuits in those Circuits only. It will continue to maintain its position in cases appealable to other circuits.

SUMMARY OF ARGUMENT

This case presents the important issue of whether the Commissioner of the Internal Revenue may amend a long-standing regulation when the effect of the amendment is to increase the tax burden on thrift institutions substantially above the level intended by Congress. The regulation at issue is Treasury regulation section 1.593-6A(b)(5)(vi) and (vii) which interprets section 593(b)(2) of the Internal Revenue Code of 1954, as amended and in force for the years at issue. Section 593(b)(2) of the Internal Revenue Code of 1954 permitted thrifts to take deductions for additions to bad debt reserves based on various percentages of taxable income. When the regulation at issue was first published in 1978[5] it changed the interpretation the Commissioner had given the statutory percentage-of-taxable-income method computation for over twenty years. The new regulation reversed the order in which NOL carrybacks and the percentage-of-taxable-income reserve addition had been applied to reduce taxable income for more than two decades under prior regulations.[6]

By limiting its review of the challenged regulation to the question of whether Congress explicitly addressed the ordering rule in 1969, the Ninth Circuit majority ignored the fact that the revised regulation undermined Congress' vigorously debated and clearly stated intentions with regard to the level of tax to be imposed on thrifts. Stated another way, it is clear that in 1969 Congress must have relied upon the 1964 regulation's computation of the taxable income base when it determined the revenue to be raised from increasing the effective tax rate of thrifts by reducing the applicable percentages under the percentage-of-taxable-income reserve method.

The ordering rule of the regulation at issue is not a detail left to administrative interpretation. Instead, it is an essential component of the tax base assumed by Congress in making its revenue determinations in 1969. The issue is one of materiality — a rule that, in contravention of prior judicial and administrative precedent, would cause years of reserve accumulations to be eliminated by later losses cannot be viewed as a detail.[7] As pointed out by one Tax Court judge, to hold otherwise is to render the hard-fought battle over the level of

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[5]Treasury regulation 1.593-6A(b)(5)(vi)(1978). The regulation was made retroactive the following year as Treasury regulation section 1.593-6A(b)(5)(vi) and (vii)(1979).

[6]See Treasury regulations, section 1.593-1(b)(1) (1956) and section 1.593-6(b)(2)(iv) (1964).

[7]In this case, the regulation has the effect of wiping out virtually all of the Petitioner's bad debt reserves accumulation during the decade of the 1970's.

the section 593 deduction "comical;"[8] the Commissioner could radically alter the actual revenue results by a pen-stroke nine years later.

The urgent need for a uniform national rule and clarification that deference cannot be extended to regulations that defeat the fundamental revenue objectives of Congress present the most compelling reasons for granting the petition for a writ of certiorari in this case. SCBA urges the Court to grant the petition for writ of certiorari and to consider the significance of these issues and the disparate treatment of similarly situated taxpayers that is likely to occur if the issues presented by this case are not resolved by the Court.

REASONS FOR GRANTING THE WRIT

I. The Ninth Circuit Majority Erred in Ignoring Congress' Reliance on the 1964 Treasury Regulations.

The Tax Court held that the regulation at issue was invalid because it reduced the deduction for reserve additions and thus raised the effective rate for thrifts and reduced the value of NOL carrybacks to an extent that "does not harmonize with Congressional intent."[9] The Ninth Circuit majority held, to the contrary, that it could find no evidence that Congress in amending the percentage-of-taxable-income method in 1969 had relied on or even "considered the effect of the prior regulations."[10] It is apparently the view of the Ninth Circuit majority that Congress was, in fact, "indifferent to the total percentage of economic income collected, overall, for the banking institutions in question."[11] SCBA believes, however, that the fact of Congressional reliance on the computation under the 1964 regulations of the taxable income base used to calculate the percentage-of-taxable-income deduction is implicit in the legislative history of the 1969 Tax Reform Act.

In 1969 Congress determined that the rate of tax paid by thrifts should be increased. The legislative history contains a detailed comparison of the rates of tax paid by savings and loans, mutual savings banks, and commercial banks and states that it was the Congress' intention to make relative adjustments in these rates. (See H.R. Rep. No. 413, 91st Cong., 1st Sess. 128-129 (1969) and Sen. Rep.

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[8] *Georgia Federal*, 98 T.C. at 121, (Halpern, J., concurring).

[9] *Pacific First Federal Savings Bank v. Commissioner*, 94 T.C. 101 (1990) at 112.

[10] *Pacific First*, 961 F.2d at 807.

[11] *Georgia Federal*, 98 T.C. at 121 (Halpern, J., concurring).

No. 552, 91st Cong., 1st Sess. 166 (1969).) The rates for savings and loans and mutual savings banks were made equal and raised relative to the rate paid by commercial banks.

As the Tax Court noted, the legislative history indicates that "both the House and Senate were aware of the effective rate of tax paid by [thrift] institutions and sought to increase that effective rate to different, specific extents."[12] This could have been accomplished by changing either the applicable percentages or the taxable income base to which they are applied. Congress chose to change the applicable percentages and not change the taxable income base. Implicit in this choice was Congressional reliance on the calculation of the taxable income base used in the 1964 regulations. The new ordering rule adopted by the Commissioner in the regulations at issue reduces the taxable income tax base and thus significantly increases the effective rate of tax for savings institutions above that intended by Congress.

II. The Effectiveness of the 1969 Amendments to Section 172 Requires Congressional Reliance on the 1964 Regulations.

As the Tax Court stated, "the new ordering rule reduces the value of NOL carrybacks and is therefore plainly at odds with Congress' intent to ameliorate the effects of the 1969 curtailment by granting [thrift] institutions a 'more generous net operating loss carryback [cite omitted].' "[13] (The 1969 Tax Reform Act extended the carryback period from three years to ten years for all financial institutions.) In order for this amendment to the carryback rules for financial institutions to have its intended ameliorative effect on thrifts using the percentage-of-taxable-income method in the carryback year, the ordering rule of the 1964 regulations must apply. That is, reserve deductions must be taken by such institutions before taxable income is further reduced by NOL carrybacks.

Conversely, the ameliorative effect of the 1969 amendments to section 172 is rendered nugatory by the ordering rule of the regulations at issue. An amount of the bad debt reserve deduction previously taken — equal to the applicable percentage times the amount of the NOL carryback — will be effectively recaptured into income in the amended return. Implicit Congressional reliance on the ordering rule of the 1964 regulations must be inferred if the extended NOL carryback was intended by Congress to have any application to thrifts making reserve additions using the percentage-of-taxable-income method in the carryback years.

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[12] *Pacific First*, 94 T.C. at 112.

[13] Ibid.

Further, in the view of the Ninth Circuit majority, the conflicting interpretations of sections 63(a) and 593(b)(2) by the Treasury and of section 172(b)(2) by the Tax Court "both appear reasonable" and, therefore based on precedent, the panel felt bound to uphold the Commissioner's interpretation in the new regulation.[14] SCBA believes that the Ninth Circuit majority erred in not applying the factual overlay — that thrifts on the percentage-of-taxable-income method in the carryback year will receive no benefit from the extended NOL carryback created, in part, to mitigate the reduction in the deductible percentage of taxable income — in evaluating the competing interpretations. SCBA believes the Commissioner's interpretation that thrifts on the percentage-of-taxable-income should lose the benefit of their NOL carrybacks — while all other financial institutions on the reserve method receive their full benefit — is unreasonable.

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[15]*Pacific First*, 961 F.2d at 805

CONCLUSION

The Ninth Circuit majority erred in limiting its review in the case below to the question of whether the legislative history of the amendments to sections 593 and 172 made by the Tax Reform Act of 1969 explicitly indicated Congress' reliance on the 1964 regulations. It should have also considered the issue of reliance on the 1964 regulations based on Congress' focus on the effective rates of tax paid by financial institutions.

This Court should grant a writ of certiorari to clarify that a reviewing court must not limit its effort to determine Congressional intent to the presence or absence of specific language in the legislative history indicating that intent. This Court should make clear that "where logical reasoning, applied to the sum of facts and circumstances, can disclose a clear Congressional intent, [a reviewing court is] obliged to utilize that tool."[15]

Respectfully submitted,

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[15] *Georgia Federal*, 98 T.C. at 121, fn 1. (Halpern concurring)